

Internal Revenue Service

Department of the Treasury
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Telephone Number:

Refer Reply To:
CC:CORP:BO1
PLR-116212-08
Date:
July 29, 2008

In Re:

Distributing =

Controlled =

Business 1 =

Business 2 =

State X =

z =

aa =

bb =

Dear

We respond to your March 12, 2008 request for rulings regarding certain Federal income tax consequences of a proposed transaction. The information submitted in that request and in your later correspondences dated June 2, June 18, and July 16, 2008 are summarized below.

The rulings contained in this letter are based on facts and representations

submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

Moreover, no information provided by the taxpayer has been reviewed and no determination has been made regarding whether the Transaction: (i) satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations, (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see § 355(a)(1)(B) of the Internal Revenue Code and § 1.355-2(d)), or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation (see § 355(e)(2)(A)(ii) and § 1.355-7).

Summary of Facts

Distributing, a State X corporation, is treated as an S corporation for federal income tax purposes and is engaged directly in Business 1. Distributing has aa shares of outstanding Class A voting common stock owned by six shareholders and bb shares of outstanding Class B nonvoting common stock owned by 48 shareholders (together, the "Shareholders"). Other than the right to vote, Classes A and B confer identical rights to distribution and liquidation proceeds.

Distributing owns all the stock of Controlled, a corporation that has aa shares of Class A voting common stock and bb shares of Class B nonvoting stock. Other than the right to vote, Classes A and B confer identical rights to distribution and liquidation proceeds. Controlled is a qualified subchapter S subsidiary (QSub) for federal tax purposes. Controlled is engaged in Business 2.

The financial information submitted by Distributing indicates that Business 1 and Business 2 each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the last five years.

Distributing has proposed the following transaction in order to protect Business 1 from the risk of Business 2, and also to allow the two businesses to set up a management structure that is best suited for each business.

Proposed Transaction

In order to achieve these purposes, Distributing will distribute all the stock of Controlled to Distributing's shareholders pro rata. Each of Distributing's Class A voting shareholders will receive an equal number of Class A voting stock in Controlled, and

each of Distributing's Class B nonvoting shareholders will receive an equal number of Class B nonvoting stock in Controlled (the Distribution).

Representations

The taxpayers have made the following representations in connection with the proposed transaction:

(a) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.

(b) The five years of financial information submitted on behalf of Distributing with regard to Business 1 and Business 2 is representative of each business' present operations, and with regard to each business, there have been no substantial operational changes since the date of the last financial statements submitted.

(c) Following the transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.

(d) The distribution of the stock of Controlled is carried out for the following corporate business purposes: (1) risk reduction by enhancing the protection of Business 1 from the risks of Business 2, and (2) allowing Business 1 and Business 2 to set up management that is best suited to their industry. The distribution of the stock of Controlled is motivated, in whole or substantial part, by one or more of these corporate business purposes.

(e) The transaction is not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.

(f) The distribution is not part of a plan or series of related transactions (within the meaning of § 1.355-7T) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest (within the meaning of § 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).

(g) The distribution of Controlled stock is not a disqualified distribution within the meaning of § 355(d). Within the 5-year period ending on the date of the distribution, z percent (less than 1 percent) of Class B common shares were acquired by "purchase" within the meaning of section § 355(d).

(h) The total adjusted bases and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed

(within the meaning of § 357(d)) by Controlled plus any liabilities to which the transferred assets are subject.

(i) The liabilities assumed (as determined under § 357(d)) in the transaction and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.

(j) No investment tax property for purposes of the investment tax credit will be transferred between Distributing and Controlled as part of this transaction.

(k) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Transaction.

(l) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled stock.

(m) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(n) No two parties to the Transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(o) Immediately after the Distribution, Controlled will elect to be an S corporation within the meaning of § 1361(a).

Rulings

Based solely on the information submitted and the representations made, we rule as follows:

(1) The Distribution will cause a termination of Controlled's election to be a QSub because Controlled will cease to be a wholly-owned subsidiary of an S corporation. For federal tax purposes, the Distribution will be treated as if Controlled is a new corporation acquiring all the assets (and assuming all of its liabilities) in a deemed contribution (the Contribution) from Distributing occurring immediately before the Distribution, and Distributing will be deemed to receive the Class A and Class B stock of Controlled in exchange for the Contribution (Section 1.1361-5(b)(1)(i)).

(2) The Contribution followed by the Distribution will be a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled will each be a "party to a reorganization" within the meaning of § 368(b).

(3) No gain or loss will be recognized by Distributing upon the Contribution (§§ 361(a) and 357(a)).

(4) No gain or loss will be recognized by Controlled upon the Contribution (§ 1032(a)).

(5) The basis of each asset deemed received by Controlled will be determined in accordance with §§ 362(b) and 362(e).

(6) The holding period for each of the assets deemed received by Controlled will include the period during which such asset was held by Distributing (§ 1223(2)).

(7) No gain or loss will be recognized by Distributing upon the Distribution (§ 361(c)(1)).

(8) No gain or loss will be recognized by (and no amount will be included in the income of) the Shareholders upon receipt of Controlled stock (§ 355(a)(1)).

(9) The aggregate basis of the Controlled stock and Distributing stock in the hands of the Shareholders after the Distribution will equal the basis of the Distributing stock held by each respective shareholder immediately before the Distribution, allocated in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§ 358(a)(1), (b) and (c)).

(10) The holding period of the Controlled stock received by the Shareholders in the Distribution will include the holding period of the Distributing stock with respect to which it is received, provided that the Distributing stock is held as a capital asset in the hands of the shareholder on the date of the exchange (§ 1223(1)).

(11) As provided in § 312(h) of the Code, proper allocation of earnings and profits among Distributing and Controlled will be made under § 1.312-10(a).

Caveats

Except as expressly provided herein, no opinion is expressed about the tax treatment of the transactions described above under other provisions of the Code or regulations, or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions not specifically covered by the above rulings. In particular, no opinion is expressed regarding: (i) whether the Distribution satisfies the business purpose requirement of § 1.355-2(b); (ii) whether the Distribution is used principally as a device for the distribution of earnings and profits of Distributing and Controlled or both (see § 355(a)(1)(B) and § 1.355-2(d)), or (iii) whether the Distribution is part of a plan (or series of related transactions) under § 355(e)(2)(A)(ii). Additionally, no opinion is expressed regarding issues relating to Controlled's subchapter S election.

Procedural Statements

This ruling is directed only to the taxpayers who requested it. Section 6110(k)(3) of the Code provides that this private letter ruling may not be used or cited as precedent.

A copy of this letter must be attached to the Federal income tax returns to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching to the return a statement that provides the date and control number (PLR-116212-08) of this ruling letter.

Pursuant to the power of attorney on file in this matter, a copy of this letter is being sent to your authorized representative.

Sincerely,

Mark Weiss
Assistant to the Branch Chief,
Branch 1
Office of Associate Chief Counsel
(Corporate)

cc: